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TREASURY DEPARTMENT
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REMARKS OF THE HONORABLE DOUGLAS DILLON
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BEFORE THE WHITE HOUSE LABOR-MANAGEMENT CONFERENCE
ON FISCAL AND MONETARY POLICY,
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None of us is satisfied with the performance of our economy over recent years. Fiscal and monetary policies play a critical role in that performance. Therefore the need for a fresh look at this area is clear.

The President will submit to the Congress in January a major program of tax reform and reduction. This program will involve a basic reworking of our fiscal structure. The results will have a major bearing on our success in meeting our economic goals, not only in 1963, but for many years ahead. We welcome your inquiry into the policy issues involved.

One of the major responsibilities of any modern society is to provide the sort of economic environment in which men and women, willing and able to work, can find useful employment. The duty of the Federal government to shape its policies to that end has been embodied in law. But our goal cannot simply be one of providing enough jobs today. We also want our economy to grow more rapidly over the years ahead. That is a must if we are to provide jobs for the new workers who will be entering the labor force in increasing numbers, if we are to banish remaining poverty, and if we are to continue to carry the heavy burdens imposed by our role in the world.

For the past five years, our country's performance in meeting these goals has clearly been inadequate. True, production is now running at record levels, 16 percent above the rate of early 1961, unemployment has been cut by 30 percent over the same period, and total profits have been well maintained. But in only one month during the past five years has unemployment dropped below 5 percent of the labor force, and a 4 percent unemployment rate -- roughly the average of the first postwar decade -- has not been closely approached since the spring of 1957. Output per manhour has increased more slowly since the mid-50's than during the earlier post-war years, and less than the average for this century.

While we have made progress toward eliminating the deficit in our balance of payments, that deficit still persists, and its eventual elimination will require continued effort. Even the price stability of recent years, gratifying as it is, can be traced in part to the same excess capacity and unemployment that are measures of our deficient performance in other directions. Tax reform and reduction can play a vital role in improving our performance.

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For a long time, we have been familiar with the use of fiscal and monetary policies to achieve full employment, an adequate growth rate, and price stability. But in recent years the balance of payments problem has added a wholly new dimension to our economic objectives and to the problems of achieving a coordinated set of financial policies. It has reinforced the urgency of one of our basic domestic goals -- maintenance of relative price stability. But, it has many other implications for economic policy as well. Thus, monetary policy must now be shaped with a view toward its impact on international capital flows, which are influenced particularly by the level of short-term interest rates. Very simply, we no longer have the freedom to follow the sort of monetary policies that would drive short-term rates to very low levels. Unless our short term rates maintain a proper relationship to similar rates in foreign markets, our funds will simply flow abroad in volume -- which we cannot afford.

But, that does not mean that we cannot maintain an ample supply of long-term credit for productive investment, for better housing, and for needed community facilities. That is what we have been trying to do, and rates for corporate and municipal bonds and for mortgages -- which are most significant for investment and business activity -- are actually lower today than during the recession months of 1961

At the same time, we have moved to improve the incentives for new investment in this country, as well as the internal flow of funds available to business.

Many of our economic difficulties can be traced to an inadequate rate of productive investment and a lessening of the intense demands for goods and services accumulated over years of depression and war.

As a result of lagging investment, we have been permitting the average age of our productive equipment to increase, and its efficiency has failed to keep pace with the potential needs of a full employment economy.

The contrast with our leading foreign competitors, who have provided much more favorable tax treatment for investment, is striking. Typically, the industrialized countries of Continental Western Europe and Japan have been investing between 1-1/2 and 2 times as much of their total output in new equipment as has the United States. Their growth rates have -- and this is no coincidence -- also averaged 1-1/2 to 2 times our own, or even higher. Furthermore, there is evidence in a number of industries that our wide advantage in technology and worker productivity has been reduced -- at the expense of our international trading position.

As a consequence, action in this area deserved first attention. It is important for domestic growth. It is also essential if we are to maintain our competitive position in markets at home and abroad.

A major part of our effort over the past year to stimulate investment has been long overdue reform in our treatment of depreciation for tax purposes. We have put into effect new guidelines and simplified, flexible administrative arrangements that will permit business the freedom it needs to depreciate equipment on the basis of its actual experience, and with full allowance for the impact of new technology on the useful life of equipment.

This administrative depreciation reform has been complemented and supplemented by the new 7 percent investment credit -- the principal provision of the Revenue Act of 1962. This measure directly increases the profitability of new investment and the after-tax income of any firm purchasing new equipment. Together, these measures are reducing the current tax load on business by $2 billion per year.

George Terborgh of the Machinery and Allied Products Institute, one of the nation's leading analysts of investment behavior, has calculated that these measures increase the potential profitability of a typical new piece of equipment by 20 percent. That would be equivalent to a 10-point reduction in the corporate tax rate, applied to the same new investment. I am confident that, as businessmen fully appraise the potential value of these measures, we will find a steadily increasing response in terms of expanded investment.

We had hoped, a year ago, that with this added stimulus, the economic recovery would carry us to full employment by the end of the current fiscal year. Unfortunately, the economy has failed to expand as rapidly as we had hoped and expected. This failure underscores something that many had already suspected -- that the natural expansionary forces in the economy are no longer strong enough to overcome the restrictive impact of an onerous tax structure which was built in the inflationary circumstances of war and the immediate postwar period. I think that both labor and management will agree that taxes today are simply too high.

The basic structure of individual income taxes -- with rates running from 20 percent on the first bracket to 91 percent at the top -- was set in the Revenue Act of 1950. Incomes have risen substantially since that time, partly reflecting real growth, but also reflecting the inflation that took place during much of the 1950's. Meanwhile, the tax structure has siphoned off an increasing proportion of buying power into Federal taxes

What is needed -- in addition to the steps we have already taken to improve the climate for investment -- is a reduction in the over-all tax load that will increase demand, and so lead to better utilization of our industrial capacity, more employment, and higher profits. But we are not merely interested in expanding

purchasing power. We also must aim at increasing incentives to work and to take risks, to cut costs and to produce efficiently.

I see no reason at this juncture for the Cuban crisis and the new international tensions to alter this analysis in any basic way. What that crisis does emphasize is something we already knew -- that we cannot delay tax reform indefinitely in the vain hope that tax reduction can be matched by cutbacks in spending. No one is more conscious that I am of the need to reinforce our controls over all expenditure programs, seeking out savings wherever they can be made, and increasing Government efficiency. That is our objective and we shall pursue it vigorously. However, there is simply no possibility within the foreseeable future that expenditures can be reduced below current levels. In fact, the expanding demands imposed by the cold war and by our growing population will make some increase inevitable. For example, defense and space expenditures will rise substantially in fiscal 1964, merely to pay for programs already underway in accordance with past appropriations.

It is now clear that our commitments to the defense and development of the free world, coupled with the current state of our economy, will mean a further budget deficit in fiscal 1964. We need not fear that deficit as inflationary, in view of the excess capacity and widespread unemployment that exist today -- and that are certain to remain with us for some time to come. It is also important to realize that tax reduction does not mean that we will face an endless succession of budget deficits. On the contrary, the tax structure we propose will generate budget surpluses as the economy provides full employment in the years ahead. The essential point is, that by increasing incentives and reducing the tax burden, the prospects for attaining sustained prosperity -- and thus budget surpluses -- will be greater than with the current tax structure.

We should also be clear about the implications of the prospective deficit for the balance of payments. There is not necessarily any direct connection between budget deficits and balance of payments deficits. If any proof is required, one need only look at the record of 1930's, when gold literally poured into this country at a time when we ran much larger budget deficits, relative to the size of the economy, than at any time in recent years. However, we must also recognize that a deficit at the wrong time can and has been inflationary, and for that reason a deficit can have a psychological influence on international flows of funds. Fortunately, there is no reason to anticipate any adverse psychological impact on our balance of payments from our current budget deficit. Responsible financial opinion abroad recognizes that a tax cut can contribute to the strength and efficiency of the American economy, and that a budget deficit will not be inflationary in current circumstances. In fact, a tax cut has been urged upon us by many abroad as a means of encouraging domestic growth.

One thing is clear. That is that the goal of our tax program will not be merely to give the economy a quick shot in the arm. Our tax program is not intended to be an antidote for a temporary cyclical anemia. It is intended to be a long-range lightening of the drag of the entire tax system on the economy, which involves both individuals and business firms.

In short, it will be tailored to deal with the economic outlook existing at the time it is enacted, but it will not be designed solely with this in mind. Our concern is not just for next month or just for next year, but for the next decade and beyond.

With that in mind, the reforms included in the program should be measured primarily against the yardstick of what they will contribute to accelerating economic growth. I can assure you they will be so measured. There will be sizable rate cuts, across the board. There will be reforms -- and not merely token reforms. And the net reduction after the reforms and rate cuts have been taken into account will be a significant one.

The President will present to the Congress next year a tax program as he has described it -- a balanced program to ensure more rapid economic expansion, in an atmosphere of greater tax equity and simplicity.

With significant tax reduction, and significant reform, and with the reforms already enacted in this year's tax legislation, we will have come a long way. The investment credit, depreciation reform, and the other gains of our tax changes, will pay benefits, in increasing number, for years to come.

Our major economic goal is not merely to cope with problems as they arise, but to make a lasting contribution to the growth potential of the American economy. The benefits, in increased employment, greater prosperity, and a stronger nation both at home and abroad, are not ones we can afford to ignore.

We have no intention of doing so, and the President's tax program will clearly demonstrate that fact.

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